IN THE 13

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of IRVING WHITEHOUSE COMPANY, a Corporation, Bankrupt

L. C. REAM, HAZEL MOWERS, MABEL CONNOR, H. E. WOODLAND, MAUDE MOWERS, OSCAR LANTOR, CHARLES THEIS, ALEXANDER STEPHENS, O. W. WITTMER, T. S. LANE, DAVID ACKERMAN, STANLEY HODGMAN, AUGUSTA W. HOWELL, *Petitioners,*

vs.

W. S. McCREA, as Trustee in Bankruptcy of Irving Whitehouse Company, a Corporation, Bankrupt, *Respondent.*

No. 3675

Appeal and Petition to Revise from the District Court, Eastern District of Washington

Appellants' and Petitioners' Brief

GRAVES, KIZER & GRAVES,
WAKEFIELD & WITHERSPOON,
ALLEN, WINSTON & ALLEN,
FABIAN B. DODDS,
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Solicitors for Appellants and Petitioners.

EMPIRE-PACIFIC PRINTING CO., SPOKANE

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STATEMENT OF THE CASE.

The proceedings on which this appeal is based were instituted by the various appellants to recover from W. S. McCrea, the Trustee in Bankruptcy of the Irving Whitehouse Company, stockbrokers, doing business in Spokane, the proceeds of certain securities, the property of appellants, which had been pledged by Irving Whitehouse Company with Hutton & Company, stockbrokers of New York. The appellants will hereafter be referred to as the "petitioners," or "claimants," Irving Whitehouse Company as "Whitehouse," and Hutton & Company as "Hutton." When amounts are referred to they will be stated in round figures unless the exact sum is material.

On August 3, 1921, a receiver was appointed by the State Court to take charge of the Whitehouse affairs, and on the 2nd of December, 1921, W. S. McCrea was duly appointed trustee in bankruptcy and is now acting in that capacity. All of these petitioners were customers of Whitehouse and on August 3, 1921, had pending open accounts with him. He had in his possession certain securities of each of these persons, and had pledged them with Hutton to secure advances made by that firm in buying and selling securities for him on the New York exchange. At the time of the appointment of the receiver, Whitehouse owed Hutton more than $37,000, and Hutton held collateral security, including the securities of these petitioners, of a value in excess of $48,-

000. Upon an order of the State Court, the receiver instructed Hutton to liquidate the Whitehouse account, and Hutton thereupon proceeded to sell all the pledged collateral. From such sale he received a surplus in excess of $10,400 over the amount owed him, and this was forwarded to the receiver and later turned over to the trustee in bankruptcy.

Of the collateral held by Hutton but $1414 was the actual property of Irving Whitehouse. The balance was composed of property belonging to persons who had paid their accounts with him in full and of property belonging to marginal customers, but by far the greater amount was the property of these marginal dealers (page 9 of Stipulation). It is stipulated in connection with the pledging of customers' securities that Whitehouse was not guilty of any wrongdoing in pledging the securities of marginal traders, but it is agreed that he was under the necessity of removing securities from the Hutton pledge and making delivery as soon as any customer paid his account in full, it being said on page 5 of the stipulation that "in all marginal dealings it was agreed between Irving Whitehouse Company and the customer that the securities purchased as well as the collateral put up by the customer to secure his account with the bankrupt might be rightfully repledged. * * * It was understood that if the amount due on any account was paid in full the bankrupt must at once deliver either the identical securities put up as collateral or purchased, or others exactly similar thereto."

The petitioners, Lantor (p. 10, Stipulation), Hodgman (pp. 11 and 12, Stipulation), Maude Mowers (p. 14, Stipulation), Ream (p. 14, Stipulation), Woodland (p. 14, Stipulation), and Howell (p. 18, Stipulation) had paid in full for their securities prior to the 3d day of August, 1921. Stephens had paid all but $15 on his account and had refrained from paying the balance simply because of a misunderstanding between himself and the bankrupt as to the amount paid for the property he had ordered. Hazel Mowers (p. 12, Stipulation), Conner (p. 13, Stipulation), Lane (pp. 15, 16 and 17 of the Stipulation) and Theis (p. 17, Stipulation) had not voluntarily paid the full purchase price of their securities, but it is stipulated that in each of these cases Whitehouse had, prior to the 3d day of August, 1921, converted to his own use such a quantity of their securities, other than those now in question, that the amount previously due him in each case had been converted to an indebtedness due from him to the several petitioners. Ackerman (p. 11, Stipulation) had delivered stock to Whitehouse with the understanding that he was to loan it, on Ackerman's behalf, to Hutton, for the prevailing call money rate, without however authorizing Whitehouse to pledge the stock as collateral on his own account. In violation of this agreement the stock was included by him in the Hutton pledge.

The referee found that on the 3d day of August, 1921, O. W. Wittmer was a marginal trader who was still indebted to Whitehouse. He also found

that although H. Sidney Collins had paid in full for his securities they had been converted by Whitehouse prior to the failure, and on the 3d of August were not included in the Hutton pledge.

On the 23d day of January, 1923, a show cause order was entered requiring all persons who had any claims to the Hutton surplus to come before the referee on the 5th day of February, 1923, or be forever estopped from asserting their claims. No persons other than these petitioners appeared at that time, and the referee thereupon awarded to each of them the full value obtained for their securities on the sale by Hutton, with these exceptions: There were claims for 68 shares of Northern Pacific while there were but 30 shares of that stock in the pledge. Each Northern Pacific claimant was, therefore, awarded his proportion of the price obtained for these 30 shares. With respect to Wittmer, the marginal trader, since the fund was not sufficient by approximately $300 to satisfy the claims of all petitioners, and since he was still indebted to Whitehouse on his account and had authorized the pledging of his stock, it was held that he was not entitled to share with the other petitioners, but might take only the surplus remaining after their claims were satisfied. H. Sidney Collins was denied any recovery at all, since he had failed to locate his property in the Hutton pledge.

The trustee appealed from the referee's order, and the District Court reversed it. An order was

thereupon entered that there should be applied to the payment of the indebtedness due Hutton a pro rata share from each security, and that, if the interest of Whitehouse in any security was not sufficient to pay the pro rata of indebtedness of such security, the difference should be supplied from the interest of the owners of the remainder of such security. Since in no case did Whitehouse own securities similar to any claimed by these petitioners, the provision that his interest should first be applied to release a portion of the indebtedness of such securities was of no avail, and the practical effect of the order was that all the securities pledged should bear jointly the burden of the lien, it being deemed immaterial whether they had been pledged rightfully or wrongfully.

This matter has been brought up to this court both by petition to revise and by appeal, because of the uncertainty as to just which method for review is proper in these particular cases (See Collier on Bankruptcy, 1923, Vol. 1, p. 829).

We are of the opinion, however, that the proper method is by petition to review.

In *re Frencis Valentine Co.*, 94 Fed. 793; 98 Fed. 414 (this court).

As said in Collier's on Bankruptcy (supra) p. 838:

> "Orders determining the rights of claimants to a fund in the possession of the bankruptcy court and being administered by it in

the course of bankruptcy proceedings, are reviewable by petition."

Gibbons vs. Goldsmith, 22 Fed., 826 (this court).
In re Antigo Screen Door Co. (C. C. A. 2d Cir.) 123 Fed. 249.
Samel vs. Dodd (C. C. A. 5th Cir.) 142 Fed. 68.
Matter of Petronio (C. C. A. 7th Cir.) 220 Fed. 269.
In re Goldstein (C. C. A. 7th Cir.) 216 Fed. 887.

Whichever procedure is deemed proper in this Court, we submit and rely upon the following Assignments of Error.

1. In reversing the order of the Referee.

2. In refusing to affirm the order of the Referee.

3. In adjudging the bankrupt or the trustee entitled to any portion of said fund until after these claimants had been paid in full.

4. In failing and refusing to order said funds to be the property of said claimants so far as necessary to pay them in full.

5. In failing and refusing to order all other claimants estopped from claiming any part of said fund.

6. In failing and refusing to hold said show cause order and the proceedings thereunder barred any other claimants to any part of said fund.

7. In failing and refusing to order that the said Trustee had no property right in said fund.

8. In failing and refusing to order the entire indebtedness of Hutton & Company to be paid from any interest the bankrupt or trustee might have in said securities, or any of them.

9. In ordering the interest of these claimants in said fund, or any part thereof, to be subject to the claim of Hutton & Company.

10. In ordering these claimants, or any of them to pay any of the sum due Hutton & Company.

11. In ordering the interest of said claimants, or any of them, to be pro rated according to ownership in each security after deducting any indebtedness, or to be pro rated at all.

12. In failing and refusing to award to those claimants who identified their particular securities among those held in the Hutton & Company pledge the amount obtained for such securities on their sale.

13. In failing and refusing to award the claimants who identified in the Hutton & Company pledge securities similar to those which the bankrupt was under obligation to be holding for them, the full value of such a proportion of the identified securities as the number of shares each of such claimants was entitled to bore to the total amount of such shares that the bankrupt was under obligation to be holding for all his customers.

ARGUMENT.

Those persons whose securities were wrongfully included by Whitehouse in the Hutton pledge have the highest equities in any surplus remaining over.

As appears from the stipulation, Whitehouse had pledged to secure his own indebtedness, a small block of stock belonging to himself; a large number of securities belonging to margin dealers, who consented to such hypothecation, and the stocks and bonds of other persons who had not authorized him to pledge their securities. It is obvious that the last class of persons have rights to any surplus that may remain over, superior to the claims of all other persons, and it appears from the stipulation that each of these petitioners with the single exception of O. W. Wittmer, is included in this class.

Courts that have considered the distribution of funds similar to that now in question, have been unanimous in awarding to those persons whose securities have been wrongfully subjected to the perils of such pledges any surplus that might remain over after the lien of the pledgee was satisfied and have divided among those who consented to the pledging of their securities only so much as remained after the first class had been satisfied in full.

One of the earliest and most widely cited cases

recognizing this principle, is that of *Skiff vs. Stoddard,* 63 Conn. 216, 21 L. R. A. 102 An action was brought by customers of insolvent brokers against the trustee to recover a surplus remaining after the satisfaction of a lien such as that of Hutton. The Court decided that, as between the customers of the brokers and the trustee, the customers who had located their securities in the pledge were entitled to the surplus. It then had occasion to discuss the claim of one Hooker, who had found certain of his securities pledged, although he had given the brokers no authority to make such hypothecation, and, since the fund was not sufficient to satisfy all claimants, it became necessary to determine whether he should pro rate with the balance of the customers, who had given authority to pledge, or should take in preference to them. On this point it was said in 21 L. R. A. 117:

> "We fail to discover in the record that Hooker ever gave Bunnell & Scranton any express authority to pledge his stocks, and we discover nothing from which an implied authority so to do can be in any way inferred. A pledgee in the absence of authority, expressed or implied, is not permitted to repledge as security for his own debt. Upon the facts appearing in the record, therefore, Bunnell & Scranton's action in hypothecating Hooker's stocks must be regarded as wrongful. The stocks pledged with his were rightfully pledged. They were either stocks of the wrongdoers and debtors, or stocks of a customer who had authorized a repledging. The plaintiff's equity is, therefore, superior to that of the owners of the other stocks, and it is right to have an

> application of their proceeds to the discharge of the pledge, before he shall be called upon to bear a burden imposed upon his property by the wrongful acts of his bailee."

Another case in point is *In re Mills,* 110 N. Y. Supp. 314. The brokers had pledged, as here, securities belonging to customers, by name, Beach, Henck and Townsend. The last two had authorized a re-hypothecation, but Beach had not. The pledgee satisfied its lien by selling all the securities of Beach and only a portion of the securities of Henck and Townsend. Beach contended that since their securities were rightfully exposed to the perils of the pledge, while hers were not, she was entitled to a lien against the property that survived, and her contention was sustained in the following language:

> "When the Colonial Bank (the repledgee) made the sale, had Mrs. Beach been advised of it, she would have had a right to insist that all of the securities which had been rightfully delivered to the bank be sold to pay the loan before her securities were resorted to, and, if a sufficient fund had been derived from the sale of the other securities to pay the loan, the bank could not have sold her securities and would have had to deliver them to her. In other words, it would have been the duty of the bank, had it been advised of the facts, to have sold the securities of the appellants, Henck and Townsend before selling hers. This is what ought to have been done, and, inasmuch as a court of equity will consider that done which should have been done, it will now direct that the stocks of Henck and Townsend be sold and the proceeds be turned over to her, in so far as

> it may be necessary to make good to her the loss which she sustained by the unauthorized sale of the 300 shares of the steel stock."

To the same effect are the cases of *In Re Ennis,* 187, Fed. 720 and *In re Wilson,* 252 Fed. 631, which are also of interest on another phase of the question herein involved, and which we may here discuss without digressing from the subject under consideration. There can be no question, but that the securities of Lantor, Hodgman, Maude Mowers, Ream, Woodland, Howell and Stephens were wrongfully pledged by Whitehouse, since it is stipulated that they had paid in full, and, since it was further stipulated that, when full payment was made, the broker was under the immediate necessity of delivering the customers' property. Also, as concerns Ackerman, it was stipulated that he had not authorized a pledge of his stocks by Whitehouse.

Some question might, however, be raised as to Whitehouse's right to pledge the securities of Hazel Mowers, Mabel Conner, T. S. Lane and Chas. Theis. Each of these had been, at the outset, margin dealers, but in each case it is stipulated that prior to the failure the bankrupt had misappropriated such a quantity of their securities as to convert their debit balances to credit balances in their favor and that, in addition, he still retained the unconverted balance of their securities in the Hutton pledge.

It has been settled that in such cases as these last mentioned the wrongful acts of the broker

deprived him of any right to hold the securities in pledge and that, after his conversion, the property of such persons must be considered as held in pledge without authority and that consequently they have equities equal to those of the customers whose property was wrongfully pledged from the outset. The first case to this effect is *In Re Ennis,* 187 Fed. 720. There, as in the case of the last named petitioners, Bamford, the claimant, had been a marginal trader and had deposited with the brokers 82 shares of Safety Car Heating stock; 30 shares of Patterson Saving Investment stock and an undisclosed number of shares of Shoe Machinery stock. Prior to the broker's failure, he had misappropriated the Shoe Machinery stock. The pledgee had satisfied his lien by the sale of certain securities, including the 82 shares of Safety Car Heating stock, and turned over to the trustee, a surplus fund and the 30 shares of Patterson Savings Investment stock. The petitioner was awarded the recovery of his stock, "subject to the payment of his proportion of the burden of the loan." This condition is explained on page 721 as follows:

> "The condition, 'subject to the payment of his proportion of the burden of the loan,' attached by the master to the order in the appellant's favor seems to mean substantially this: The Master awarded relief to two classes of claimants for securities or proceeds—Class 'A' and Class 'B.' Claimants placed in Class 'A' were held entitled, by reason of superior equities, to the specific restitution of their securities, or were awarded a lien on said surplus fund

for the amount of the proceeds of their securities, without contribution, except for expenses. The fund was insufficient to pay all claimants upon this basis, so that the claimants placed in Class 'B' in receiving less than their proportionate share of the fund, were said to contribute to the burden of the loan. The appellant was placed in Class 'B' and the primary contention made in his behalf is that he should have been put in Class 'A'."

It is interesting to note, by way of digression, that in the Ennis case the lower court recognized the difference between those whose securities had been wrongfully and those whose securities had been rightfully pledged and that the question there was simply whether or not it should be considered that Bamford's property had been improperly pledged so as to have entitled him to be included in the higher class, while in the present case, the Court has failed entirely to observe this distinction and has placed upon the claimants whose property was wrongfully pledged, the same burden as that placed upon Wittmer, whose property was rightfully pledged. But to return, it was Bamford's contention that the bankrupt, by its misappropriation of his Shoe Machinery stock, lost the right, which it admittedly had once had, to hold the balance of his stock in pledge and that, as the pledge was wrongful, he was entitled to be placed in Class "A." On this point, the court said:

At page 722:

"Broadly speaking, we approve what we consider to be the underlying principle of the

classification adopted by the Special Master, viz., that superior rights should be accorded to claimants whose securities have been wrongfully hypothecated by the bankrupts, over those whose securities have been rightfully pledged. When a broker pledges as collateral to his loan at a bank securities left with him for safekeeping or for sale, he is a wrongdoer from the outset, and, while the bank may have the right to hold the securities, the claim of the owner, upon the satisfaction of the bank's demand, is of the highest equity. On the other hand, when a broker, acting under the authority conferred upon him by a customer, hypothecates his securities, the latter may, upon the adjustment of his account with the broker and the termination of the bank's demand, reclaim his securities; but, as he has no ground for complaining that his securities were pledged, his rights are clearly inferior to the owner whose securities were wrongfully hypothecated."

At page 723:

"Now, what were the rights of the parties with respect to the securities which the appellant placed in the hands of the bankrupts as securities for his speculative account? It is the better view in our opinion, that so long as the bankrupts, as brokers, fulfill their obligations to the appellant, as customers, they have the right to rehypothecate the securities pledged to them. That was substantially the only way in which the collateral could have been made available, and, in view of modern business conditions, we think that such use must have been within the contemplation of the parties. But it must be equally true that if the bankrupts converted to their own use the stocks of the appellant which they were carrying for him, or misappropriated the property deposited with them, they violated the duties which they owed

him and their right to use the securities for their benefit terminated."

At page 724-5:

"For these reasons, we are of the opinion:

(1). That the hypothecation of the shares in question was not necessary for the purposes for which they were deposited with the bankrupts.

(2). That the bankrupts, by their misconduct in misappropriating the Shoe Machinery stock belonging to the appellant, lost their right to the continued use of his other property.

(3). That the bankrupts, by the conversion of the appellant's 'long' securities and failure to carry them, lost their right to the continued use of collateral deposited as margin on stocks to be actually carried.

(4). That for some time prior to the failure the bankrupts owned the appellant the duty of withdrawing the securities in question from the pledge in the Mechanics' Bank and of surrendering them to him.

(5). That, consequently, the securities in question at the time of the failure, stood in the Mechanics' Bank in the position of securities wrongfully pledged.

(6). And, as a corollary to these conclusions, we further hold that the equities of the appellant entitle him to be placed in Class 'A,' instead of Class 'B'."

It would seem, from a casual reading of the following case, *In Re Ennis,* 187 Fed. 726, which arose from the same matter, that Bamford was placed in Class "A," because the conversion of his securities had been sufficient, as in the case of these petitioners, to convert his debit balance to a credit balance without taking into consideration the value of stock left in pledge and that Braun, in the latter

case, was placed in Class "B" because it appeared that, notwithstanding the conversion of some portion of his stock, it had not been made to appear that such conversion had wiped out his indebtedness so that consequently the bankrupt had a lien against the securities left with him which entitled him to repledge them. These two cases have been harmonized in the case of *In re Wilson,* 252 Fed. 631 in the Court's discussion of Godwin's case, pages 642-650. The claimant, as here, had been a marginal trader and had pledged with Wilson, the broker, a large number of stocks. Wilson had repledged all and had converted a portion, but not such a portion as to wipe out Godwin's indebtedness to him, if the value of the other securities, which had been repledged but not converted, was left out of consideration. The Court points out that there is no conflict between the two Ennis cases, but that the true rule is that, if, upon a restatement of the entire account of the customer, it appears that there is a credit balance in his favor and that some portion of his securities have been converted, he will be entitled to be grouped in Class "A," irrespective of whether or not the conversion has been sufficient per se to wipe out his debt. Whether these cases can be so harmonized, is not of importance here, since it was stipulated that the conversion of these petitioners' securities had in each case been sufficient, per se to wipe out the debit balance due from each of them. Therefore, all these cases are clearly to the effect that Hazel Mowers, Mabel Con-

ner, Lane, and Theis are entitled to be grouped with the other petitioners in Class "A."

See page 650 of the Wilson case, where it is said:

> "First: As between securities hypothecated with authority and those hypothecated without authority, obviously the latter have the superior equity.
>
> Second: Where securities are hypothecated without authority, or, though hypothecated with authority, are in part subsequently converted, the securities remaining stand on equal equities, provided that, as the result of the conversion of securities originally rightfully hypothecated, the restatement of the whole account shows a credit balance in favor of the customer.
>
> Third: Where securities have been rightfully hypothecated, and there has not been any conversion of any of such securities, then the equity of the customer owning such securities is inferior to that of customers owning securities as described in paragraph first and second."

The cases cited below are in harmony with those just referred to.

In re Hollins, 232 Fed. 124.
In re Stringer, 230 Fed. 177.
In re Stringer, 233 Fed. 799.
In re Toole, 274 Fed. 337.
Harmon vs. Sprague, 163 Fed. 486.

In *In re Hollis* supra, it is said:

> "When a bankrupt has made a loan, and to secure the same has pledged his own securities, securities of his customers rightfully, and securities of his customers wrongfully, the customers become sureties for him as principal to the lender. The securities must in equity be applied to the payment of the loan as follows: First, the bankrupts; Second, the customers'

> securities rightfully pledged; and, Third, the customers' securities wrongfully pledged."

The petitioners have identified their securities in the Hutton pledge. It appears from the stipulation that the great majority of the other securities pledged were the property of marginal dealers who had authorized Whitehouse to deal with their property in the manner followed. Hence, it appears, under the cases cited above, that these petitioners have proved that they stand in the most favorable position possible. It should seem, therefore, that they have clearly established, as between themselves and the Trustee, who, in so far as this fund is concerned, stands in the shoes of Whitehouse, the wrongdoer, that they are entitled to the proceeds of their property. They have, however, gone further than to prove themselves possessed of the highest equities, and have proved that they hold not only the most favorable position possible, but that there are no other persons who can assert any right to this fund.

On January 23, 1923, the Referee entered an order directed to all persons who claimed any portion of this fund, ordering them to show cause before the 5th day of February, 1923, why the fund should not be disbursed to the petitioners, and further providing, that the service therein contemplated should be sufficient to bar all claimants from asserting any right to the aforesaid fund who did not appear to prove an interest therein on the return day. The procedure followed was customary and has always

been held effective:

See

In re Ennis, 198 Fed. 391.
In re Lathrop, Haskins & Co., 223 Fed. 912.
In re Gay & Sturgis, 224 Fed. 127.

In the case of Lathrop, Haskins & Co., at page 117, it is said:

> "This brings us to inquire whether the District Court had the power to make the order of March 24th, providing that all claimants who did not file 'notice of claims to the said stock' on or before May 1, 1910, should be forever barred from making any claim or asserting any title or interest in or to any of the stocks, bonds, or securities of this estate or the proceeds thereof.' In answering that question it is to be observed that the order expressly provided that it was 'not to be construed to bar any creditor from his right to file a proof of claim as general creditor against this estate within one year after the order adjudicating the above named bankrupts.' In other words, the order did not fix a time for general creditors to file claims against the estate. That the court could not have done as the Bankruptcy Act, in providing in Section 57, subd. 'n' that 'claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication,' plainly implies that creditors shall be entitled to file claims against the estate at any time within the year. But the Court sought by its order to require persons claiming stocks or bonds then in the possession of the receiver, or which might subsequently come into his possession, or in the possession of the trustee, to give notice of their claims within a time specified or be barred of the right to recover them from the receiver or trustee. We are at a loss

> to understand why the authority of the court to make such an order should be denied. It is said that such an order is in effect a short statute of limitations, and that as such beyond the power of the Court to establish. In making the order the court was in the exercise of its equity jurisdiction. The equity courts, in jurisdictions where the distinction between law and equity is maintained, while not bound by statutes of limitation not in totidem verbis applicable to equitable demands, have nevertheless from the earliest times asserted the right to adopt and apply statutes of limitation to cases over which their jurisdiction was concurrent with that of the courts of law. And in cases over which the courts of equity have exercised an exclusive jurisdiction they have acted upon the maxim 'vigilantibus non dormientibus aequitas subvenit' and recognized laches as a defense peculiar to the chancery courts, and refused to grant relief to one who has unduly delayed the prosecution of his claim. And it has also been the practice of equity courts in appointing receivers to limit the time within which claimants could assert a claim against the receivers so appointed. In the exercise of the right thus to limit rights of action the equity courts have not derived their power from any statute but have exercised an inherent power. It is too late, in the history of these courts to challenge their right in this respect."

In concluding the discussion of our theory of recovery, let us for a moment forget the fact that we are dealing with a case involving stockbrokers and their customers. Let us suppose a case exactly similar, but involving a different business and the pledging of different forms of property. Suppose the customers of a furniture dealer left in his pos-

session, for repair, furniture, and that he, in violation of his trust, pledged it or otherwise encumbered it and that the person who accepted the pledge acted in good faith, that thereafter the furniture dealer failed and a trustee was appointed. Would it be supposed for a moment that the trustee would be entitled to any surplus that might remain after the claims of the pledgee were satisfied as against the creditors of the furniture dealer, who had identified articles of household furniture in the pledge? Suppose a stronger case and one more nearly in point; one of the customers of the dealer finds in the pledge certain tables and chairs belonging to him. A surplus remains over, and he institutes proceedings in rem to establish his interest in it. Service is duly had on all other persons who might in any way be interested in this fund and none of them put in an appearance. Would it in such case be contended that the trustee who had received the surplus, merely because there was no one else to pay it to at the time it became available, that he, who stands in the shoes of the dealer who has defrauded his customer in pledging the property, has an interest or may assert any claim against the customer who has thus established his rights? And if this be true of the case supposed, wherein does the case now before the court differ?

The District Court erred in conceiving that the doctrine laid down in the Pierson case was applicable to the situation now before the court:

It was the Trustee's theory that these petitioners

must bear equally with all other persons whose securities were included in the Hutton pledge the burden of its lien, or, in other words, that there must be equal contribution among all such persons, and that, if the owners of the other securities failed to put in an appearance, the trustee by some mystic metamorphosis of title took their interest in the fund. He relies on the case *In re Pierson,* 238 Fed. 142 to support his contention.

To obtain any proper appreciation of the holdings of this case, it is necessary to review the several earlier cases leading up to it. Four claimants, Van Tynn, Vreislander, Levy, and Quinn sought to recover the surplus of certain securities belonging to them which they claimed to have identified or traced in a pledge, similar to this. They did not identify their stock by certificate numbers or in any other definite fashion, but contented themselves with proving that they were entitled to a certain form of security and that similar securities were included in the pledge in question. It was their belief that this was a sufficient identification of their property, under the case of *Gorman vs. Littlefield,* 229 U. S. 19. The District Court held, however, in 225 Fed. 889 that the case under consideration was distinguishable from *Gorman vs. Littlefield* in the following respect: There the claimant, although he was unable to identify his property positively, as by certificate numbers, found a block of stock sufficient to satisfy, not only his claim, but the claims of all other long customers of the bankrupt, while in the case at bar,

although there was enough on hand to cover the amounts actually claimed, yet the amount was not sufficient to cover the demands of all long customers of the bankrupt, and the court held that in such case there could be no presumption that the property was being held for the bankrupt's customers, and that hence there was no identification of the property in the pledge. The District Court was affirmed in 233 Fed. 519, where it was said:

> "The rationale of the decision (*Gorman vs. Littlefield*), is that if the receiver has enough or more than enough, of the particular stock to cover all customers who were long on the day of the failure, then the presumption that he intended to keep their stock on hand is sufficient identification of the stock, or of so much of it as is needed, as theirs. If, however, the stock on hand, though sufficient to cover all actual claims, is not sufficient to cover all the long customers, no such presumption arises."

Very shortly after this opinion had been handed down, a similar state of facts were brought to the attention of the Supreme Court in the case of *Duel vs. Hollins,* 241 U. S. 523. Here the stock found was not sufficient to cover the claims of all long customers. The Court held that the principle of *Gorman vs. Littlefield* nevertheless applied and permitted each claimant to recover the value of such a number of shares as the amount he was entitled to bore to the amount all long customers were entitled to. Application of the rule was made as follows: There were four persons who were long in the particular security. Bamberger was entitled

to 30 shares; Duel, 100; Weiner, Levy & Company, 50, and Landau, 100, the total being 280. There were but 100 shares on hand. Apparently only Duel and Weiner, Levy & Company made any claim to the stock. It was therefore held that Duel had identified 100/280 of the one hundred shares and that Weiner, Levy & Company had identified 50/280 of the one hundred shares and that each would receive the proceeds of the amounts thus identified.

When this opinion was handed down, the Pierson case was again called to the attention of the Circuit Court of Appeals in 238 Fed. 142 and the previous opinion was overruled. It was then held, as in *Duel vs. Hollis,* that the four claimants had identified and were entitled to receive their "pro rata shares of the respective stocks on hand" and that the proportion which they would be considered as having identified could not be increased by the fact that other customers had made no claims.

It must be apparent that this case does not give any support to the Trustee's contention and the order sought to be reviewed. No question is involved of any contribution among the various persons whose securities were identified in the pledge. An examination of the cases leading up to it shows that the only question raised was whether the petitioners had identified or traced their securities in the pledge, and this question of identification was the only one involved. The holding is that where there are insufficient securities in the pledge to meet

the claims of all long customers, each petitioner will be considered to have identified but his proportion of those on hand.

A similar case might easily have arisen in the present proceedings in the case of Northern Pacific stockholders. There were long customers of Whitehouse entitled to 68 shares of this security; Hazel Mowers claiming 5 shares; Mabel Conner, 5; H. W. Woodland, 15; Maude Mowers, 23, and Hodgman 20 shares, and there were on hand in the Hutton pledge but 30. The Referee held that each had identified his proportion of the security, for instance, Hazel Mowers identified 5/68 of the 30 shares and received the value of such identified shares of stock; Woodland identified 15/68 of 30 shares and received the value of these shares. Suppose, however, that Hazel Mowers had alone made a claim and that the others had not come before the Court. It is apparent that in such case it could not be held that she had identified a greater proportion of the stock than if all the others were before the Court.

The Pierson case then simply goes to the question of what is necessary to identify securities in the pledge. No question of contribution or of classification, according to the equities of those who have identified or traced their securities, is raised. Indeed it is not until after the securities have been traced in the pledge and the proper amount of securities so traced have been awarded to the various claimants, that there can be any grouping into

classes "A" and "B." And from this it is evident that the application of the doctrine of the Pierson case is a step preliminary to the classification of the petitioners, according to their equities. As is said *In re Wilson,* 252 Fed. at page 653-654:

> "Where, by reason of conversion, less shares of a certain stock are found 'in the box' than are necessary to satisfy the claims of 'long' customers, the procedure is first to trace. If a claimant identifies his stock by certificate number, etc., he is entitled to reclaim that stock or its proceeds. After such specially identified shares are withdrawn from the total of shares, the remaining claims will be pro-rated under *Duel vs. Hollis,* supra. *After the proper pro-rata has been assigned to each claimant who has successfully traced, then the equities of the claimants will be considered, in order to determine whether the claim falls under Class 'A' or class 'B'."* (Italics ours.)

It must be apparent from the foregoing that there is nothing in the Pierson case to warrant the assertion that it supports the Trustee's position. There seems to be no support for it in the authorities, is there any in reason or in equity? His claim is that all persons whose securities were held in the pledge must contribute, to release its lien, a proportion based upon the value of their securities. This, undoubtedly, would be true, if all the persons stood in the same position, if all asserted their claims, and if the fund was insufficient to satisfy the demands of all, but these circumstances do not here exist. The Trustee has at all times failed to take into consideration the fact that all the petitioners, with the single ex-

ception of Wittmer, are Class 'A' claimants, that is, are persons whose securities were wrongfully placed in the Hutton pledge and has likewise failed to take into consideration the fact that the surplus is more than sufficient to satisfy all such claims. It should be apparent that there can be no claim of contribution between such persons and those who voluntarily placed their property in the Hutton pledge, and that as between Class 'A' claimants there is no necessity of contribution, since the funds on hand are more than sufficient to satisfy their demands.

In the case of *In re Toole,* 274, Fed. 337, the court discusses the circumstances under which contribution is necessary. One Foster had been a margin dealer and discovered upon the failure of the broker that certain of his stock had been pledged. The pledgee did not sell all the collateral that he held, but, after satisfying his lien, returned to the Trustee a surplus fund together with certain securities including the stock of Foster. He thereupon brought suit for the immediate recovery of his property. At the time there was an omnibus proceeding instituted by a number of petitioners to recover their respective stocks, and the Lower Court ordered that the Foster claim be heard with the claims of the others and that the claim should be "determined in accordance with the rights and equities of those similarly situated." He appealed on the ground that since his property had actually survived the pledge, he was entitled to its specific return, but the Court held

that his claim should be consolidated with the others, saying that the mere chance that his property had survived should not place him in a better position than those whose property had been pledged with his under similar circumstances but, by mere chance, had been sold, and held that if it appeared that there were others who had the same equities and the fund was insufficient to satisfy all their claims, there should be a joint contribution. The court very clearly states the true rule governing the situations where contribution shall and shall not be enforced.

See pages 344 and 345, where it is said:

> "We think that, when customers authorize their broker to pledge their securities for the payment of the broker's debts, each becomes to the extent of his pledge a surety for the payment of such indebtedness. As between themselves they become co-securities. All the collateral lawfully so pledged is subject to the same obligation and lien. The owners of the collateral, being in effect cosureties, must be entitled to contribution from each other for any loss sustained if the stock of one is sold to pay the debt for which the stock of the other was equally liable. This right of contribution does not arise from the contract, as already said, but rests upon principles of equity and natural justice. The principle is that where all are equally liable for the payment of a debt all are bound equally to contribute to that purpose. So that if the stock of A. B. & C. is lawfully pledged for the payment of the debt of X, the stock of each is under the common burden, and if X sells the stock of A. and B., and leaves unsold the stock of C., the latter must contribute to A. and B. the

> excess they have paid above their share. *But if, on the other hand, the stock of A. is lawfully pledged, while that of B. and C. is unlawfully pledged, there is no obligation on the part of B. and C. to contribute, for there is no common burden between A. on the one side and B. and C. on the other. The principle applies only in cases where the situations of the parties are equal as equality among persons whose situations are not equal is not equitable.* (Italics ours).

In conclusion, it is not amiss to give a resume of the situation. We have identified, in a certain pledge, our property, the major portion of which is as capable of a positive identification as the table and chairs in the supposed case. We have demonstrated that this property was wrongfully pledged, while the greater majority and possibly all the remainder was rightfully pledged. We have, by the show cause order of January 23d, 1923, shut off any other persons who might claim any interest in the fund and have established, if under such circumstances such fact may ever be established, that our interest is exclusive. This being true, must we be forced to deliver to the Trustee, who, in so far as these proceedings is concerned, stand garbed as the wrongdoer, Whitehouse, the lion's share of our property, under the guise that we are contributing jointly in bearing the burden of the pledge, with persons whose equities, had they come before the court, would have been held inferior to ours, and

who have been shut off from any claim of ownership?

Respectfully submitted,

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